Credit Opinion: Federal Home Loan Bank of San Francisco

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San Francisco, California, United States

Ratings

Category	**Moody's Rating**
Outlook	Stable
Bank Deposits	Aaa/P-1
Parent: Federal Home Loan Banks	
Outlook	Stable
Senior Unsecured	Aaa
Other Short Term	P-1

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Key Indicators

Federal Home Loan Bank of San Francisco

	[1]**2009**	**2008**	**2007**	**2006**	**2005**	**2004**
ROAA (%)	**0.16**	**0.14**	**0.29**	**0.23**	**0.18**	**0.18**
ROAE (%)	**4.88**	**3.54**	**6.94**	**5.31**	**4.76**	**4.26**
Net Interest Margin (%)	**0.60**	**0.58**	**0.48**	**0.42**	**0.29**	**0.34**
Advances ($bil)	**203.90**	**235.66**	**251.03**	**183.67**	**162.87**	**140.25**
Investments ($bil)	**59.60**	**60.67**	**38.60**	**30.43**	**26.82**	**24.44**
Assets	**270.29**	**321.24**	**323.00**	**244.92**	**223.60**	**184.98**
Equity ($bil)	**9.49**	**9.79**	**13.60**	**10.75**	**9.65**	**7.90**
Liquid Assets/ST Debt (%)	**6.86**	**14.00**	**16.02**	**26.44**	**25.73**	**17.99**

[1] For the quarter ended March 31, 2009

Opinion

SUMMARY RATING RATIONALE

Federal Home Loan Bank of San Francisco (FHLBank) Aaa/Prime-1 long- and short-term deposit ratings reflect the combination of the following factors: 1) a stand-alone Baseline Credit Assessment (BCA) of 5 (on a scale of 1 to 21, where 1 represents the lowest credit risk), 2) very high cooperative support from the FHLBank System, 3) very high support from the U.S. government (Aaa debt rating).

The FHLBank of San Francisco's BCA of 5, which is an A1 equivalent on Moody's long-term debt rating scale, reflects Moody's opinion about the FHLBank's intrinsic or stand-alone financial strength and exclude extraordinary support, either from the FHLBank System or the U.S. Government. The rating incorporates the FHLBank's stable risk-adjusted profitability, sound liquidity and excellent asset quality. The FHLBank's liquidity (deposits plus debt maturing within one year less liquid assets (cash, interest bearing deposits, fed funds, trading securities and available-for-sale securities as a percentage of total assets) is in the lower end relative to other FHLBanks. The FHLBank had an exposure of $22.4 billion (36% of the investment portfolio or 8% of total assets) to private-label residential mortgage back securities at March 31, 2009. Approximately 46% of the non-agency RMBS carried a Aaa rating while 31% had a credit rating below investment grade. Moody's views the FHLBank have the financial flexibility to absorb additional credit loss in the portfolio.

The FHLBank of San Francisco's BCA of 5 does not benefit from support from the FHLBank System given the FHLBank System's BCA of a 5 (A1 equivalent). On the other hand, Moody's very high U.S. government support assumption lifts the FHLBank San Francisco's deposit ratings to Aaa.

Credit Strengths

Credit strengths include:

- Joint and several liability reduces default risk of Systemwide liabilities

- Central housing funding role for banks and other financial institutions

- Excellent asset quality reflects conservative underwriting standards and strong quality-monitoring policies

Credit Challenges

Credit challenges include:

- Narrow charter and bank consolidation limit growth

- Substantial single borrower concentrations

Rating Outlook

Moody's stable outlook for the FHLBank of San Francisco's rating reflects the FHLBank's consistent returns and its low exposure to private-label MBS. Moody's expects the FHLBank of San Francisco to conservatively manage its business in achieving a modest but stable risk adjusted return.

In addition, Moody's expectation that the FHLBank System will continue to receive strong bipartisan political support, that there will be minimal changes, if any, to its government sponsored enterprise (GSE) status over the long - term.

What Could Change the Rating - Up

Factors that would lead to an upgrade of the FHLBank of San Francisco's baseline credit assessment include capital levels well in excess of regulatory requirements (e.g., capital-to-assets ratio consistently 50 bps above the regulatory requirement - currently 4.0%), consistent risk-adjusted returns while maintaining strong asset quality.

What Could Change the Rating - Down

Factors that could lead to a downgrade of the Aaa/Prime-1 long- and short-term deposit ratings and baseline credit assessment include a material decline in profitability (quarterly net losses over four quarters), significant asset-liability mismatches, or material changes in asset quality.

In addition, any regulatory or statutory changes to the System's mission or GSE status that alters the FHLBank's risk profile could also impact the ratings. However, Moody's views these potential events as highly unlikely to occur.

DETAILED RATING CONSIDERATIONS

The FHLBank of San Francisco lends to member institutions in Arizona, California, and Nevada in the form of advances, which are generally short-term (60% of advances mature within one year) and over-collateralized, minimizing the credit risk on these loans. Moody's baseline credit assessment represents our opinion of the likelihood that the institution will require extraordinary support from an external party. The high BCA of 5 reflects FHLBank of San Francisco's strong credit culture, stable, though moderate, profitability, and the benefits associated with the joint and several liability of the FHLBank System. Below are the detailed rating factors that influence the FHLBank's ratings and outlook.

Profitability

FHLBank of San Francisco's modest but consistent profitability (as measured by ROAA) reflects primarily low risk profile of its asset base. ROAA was 0.24% for the rolling twelve months ended March 31, 2009, compared to 0.27% (adjusted for OTTI) and 0.25% for years end 2008 and 2007, respectively. At March 31, 2009, the five-year standard deviation of ROAA was 0.03%, which was well below the 0.40% standard deviation for banks rated Aa and higher.

Similar to many other FHLBanks, the FHLBank of San Francisco has significant borrower concentration: its top three advance borrowers represented 68% of advances outstanding as of March 31, 2009. The largest borrower, Citibank N.A., accounts for 36% of the FHLBank's total advance at March 31, 2009. Also, bank consolidation reducing demand for advances will further constrain the FHLBank of San Francisco's profitability.

Capital Adequacy

FHLBank of San Francisco is required by legislation to maintain minimum regulatory capital level of 4% of its total assets. At March 31, 2009, the capital ratio of the FHLBank was 5.27%, up from 4.21% at year end 2008. The increase in total capital-to-assets ratio from December 31, 2008 to March 31, 2009 was primarily due to increased excess capital stock resulting from the decline in advances outstanding, coupled with the FHLBank's decision not to repurchase excess capital stock.

In Moody's view, the FHLBank's capital levels reflect the low risk profile of the FHLBank's asset base which is largely comprised of advances to member banks (75% of total assets as of March 31, 2009).

Interest Rate Risk Management

The FHLBank of San Francisco conservatively manages its interest rate risk exposures through the use of debt with similar characteristics to the FHLBanks assets, as well as derivatives. The FHLBank's primary asset is advances (75% of total assets), which come in a variety of types, including fixed rate, variable rate, callable by the FHLBank as well as putable advances. With a putable advance, the FHLBank purchases a put option from the member that allows the FHLBank to terminate the fixed rate advance on specified dates and offer, subject to certain conditions, replacement funding at prevailing market rates. Prepayment fees, which mitigate interest rate risk, are also a common feature of advances.

Beginning in May 2008, the FHLBank uses net portfolio value of capital sensitivity as the primary metric for measuring the Bank's exposure to changes in interest rates. The FHLBank's net portfolio value of capital sensitivity policy limits the potential adverse impact of an instantaneous parallel shift of +/- 100-basis-point change in interest rates from the base case to no worse than -3% of the estimated net portfolio value of capital. In addition, the policy limits the potential adverse impact of an instantaneous +/-100-basis-point change in interest rates measured from interest rates that are 200 basis points above or below the base case to no worse than - 4% of the estimated net portfolio value of capital. The Bank's measured net portfolio value of capital sensitivity was well within the policy limit as of March 31, 2009.

Asset Quality and Credit Risk Management

Moody's believes that the asset quality of the FHLBank of San Francisco is exceptional. Advances represent 75% of total assets as of March 31, 2009, while the FHLBank's investment portfolio represents 23%. Advances are over-collateralized and the FHLBank has never incurred a loss on an advance in its 76 year history. The FHLBank of San Francisco has member concentration, similar to other FHLBanks. However, the Bank has substantial single borrower concentrations which heighten its counterparty credit risk. The top three advance borrowers, Citibank, JPMorgan Chase, and Wachovia, represented 68% of FHLBank of San Francisco advances outstanding as of March 31, 2009. The largest borrower, Citibank, accounts for 36% of total advance.

The Bank no longer participates in the MPF mortgage purchase program. FHLBank of San Francisco's run-off book of MPF business declined to $3.6 billion at March 31, 2009 from $3.9 billion as of June 30, 2008 and $4.1 billion as of year end 2007. The credit quality of Bank's MPF portfolio remains excellent. Only about $11 million in mortgage loans acquired as a part of this program were classified as non-accruing or impaired at March 31, 2009.

The FHLBank's $61.6 billion in investments consists of high quality investments in fed funds sold ($12.4 billion), interest bearing deposits in banks ($8.4 billion), and agency MBS ($13.4 billion). Including in the $61.6 billion investment portfolio was $22.4 billion of private-label RMBS with approximately 46% of the portfolio carried a Aaa rating while 31% had a credit rating below investment grade. Moody's expects deterioration in the performance of the FHLBank's private label RMBS. Nonetheless, Moody's views the FHLBank's capital position will enable it to absorb addition credit losses.

Liquidity and Funding

U.S. Treasury securities. More recently, investor concerns regarding the U.S. housing and mortgage markets have affected the FHLBanks' debt pricing and funding. In addition, U.S. government actions in support of banks by guaranteeing their debt issuance has negatively impacted the FHLBanks' debt spreads. During 2008, demand for term agency debt weakened considerably. The decline in demand for debt issuances with maturities between one-year and 30-years resulted in a dramatic widening of the spread between the FHLBanks' debt and U.S. Treasury debt. Moreover, increased demand for short-term agency debt (i.e., debt with maturities of less than one year) resulted in lower yields on the FHLBanks' discount notes. As a result, the FHLBanks' funding needs were being met primarily through the issuance of discount notes, floating-rate notes, short-term callable bonds and short-term bullet bonds during the third quarter of 2008.

In September 2008, the FHLBanks entered into a lending agreement with the U.S. Treasury, which established the Government Sponsored Enterprise Credit Facility (GSECF), a secured lending facility, to serve as a liquidity backstop. The GSECF expires on December 31, 2009, but will remain in effect as to any loans outstanding on that date. Any funding to FHLBanks under the GSECF will be provided by the U.S. Treasury in exchange for eligible collateral consisting of advances issued by FHLBanks and MBS issued by Fannie Mae and Freddie Mac. Collateral haircuts will be determined by the U.S. Treasury. Loans under the GSECF are intended to be for short durations of between one week and one month. Interest on borrowings will be set by the U.S. Secretary of the Treasury.

In November 2008 and March 2009, the Federal Reserve announced a plan to purchase up to $400 billion of direct debt obligations of Freddie Mac, Fannie Mae and the FHLBanks, as well as $1.25 trillion of MBS guaranteed by Freddie Mac, Fannie Mae and Ginnie Mae. The Federal Reserve announced this action in order to reduce the cost and increase the availability of residential mortgage credit. Moody's believes these actions reduce the FHLBank's funding risk. The FHLBank's access to the term debt markets improved during 2009.

The FHLBanks' internal sources of liquidity are modest. The FHLBanks are mandated by regulation to maintain a minimum of five days of liquidity without access to the capital markets (a tiny amount), though individual FHLBanks have the discretion to maintain longer periods of liquidity without access to the capital markets and generally do so. Internal sources include the FHLBank's short-term investments, as well as the FHLBank's investment portfolio.

As of March 31, 2009, the FHLBank of San Francisco had approximately $181 billion in short-term consolidated obligations, which includes discount notes and bonds maturing within a one year period. In total, short-term debt comprised about 71% of total debt - a very high figure, compared to 68% at year end 2008. This amount has grown over the past year due to the limitations with long-term funding in the agency market. Liquid assets include cash, cash equivalents, federal funds as well as portfolio of trading securities. These assets are of high quality. Liquid assets were approximately 8% of short-term debt as of March 31, 2009. The FHLBank of San Francisco also maintains $122 billion of advances that mature within one year.

Support and Dependence

The FHLBank of San Francisco's high dependence and support levels are based on the importance of the System to its member institutions, and their ability to support housing finance and community development.

appraisal and rating services rendered by it fees ranging from $1,500 to approximately $2,400,000. Moody's Corporation (MCO) and its wholly-owned credit rating agency subsidiary, Moody's Investors Service (MIS), also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually on Moody's website at www.moodys.com under the heading "Shareholder Relations - Corporate Governance - Director and Shareholder Affiliation Policy."